

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS AMERICAN WATER COMPANY)	
)	Docket No. 16-0093
Proposed general rate increase in)	
Water and Sewer rates)	

THE PEOPLE OF THE STATE OF ILLINOIS' INITIAL BRIEF

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AG Initial Brief - Schedules A-C

AG Initial Brief – Revenue Requirement Schedules – Zone 1

AG Initial Brief – Revenue Requirement Schedules – Lincoln

AG Initial Brief – Revenue Requirement Schedules – Pekin

AG Initial Brief – Revenue Requirement Schedules – Wastewater

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Pursuant to section 200.800 of the Rules of Practice of the Illinois Commerce Commission¹ (the “Commission” or “ICC”), the People of the State of Illinois (the “People” or the “AG”), through Lisa Madigan, Attorney General of the State of Illinois, submit their Initial Brief in the above-captioned docket. The AG’s brief follows the agreed-to brief outline submitted to the Administrative Law Judges on August 8, 2016. The Peoples’ Initial Brief address various accounting-related and rate design issues, as well as the proper return on common equity (“ROE”) the Commission should adopt in this case.²

I. Introduction

Illinois American Water Company (“Illinois-American,” “IAWC,” or “the Company”) filed tariffs with the Commission seeking to increase water revenues by \$43,192,246 (or 20.52% increase) and to increase its wastewater revenues by \$6,302,300 (or 48.08% increase) equaling a total Company revenue increase of \$49,494,546 (or 22.13% increase). IAWC’s direct filing is summarized below.

¹ Ill. Admin. Code §200.800.

² Failure to address any issue should not be interpreted as a concession to any particular point of view. Moreover, the AG reserves the right to comment on, or respond to, any issues in subsequent briefing.

COMPANY DIRECT POSITION			
Division	Rate Request - \$	Pro Forma Present	Rate Request %
	<u>(IAWC Ex. 4.01)</u>	<u>(IAWC Ex. 4.01)</u>	<u>(Col (a)/Col (b))</u>
	(a)	(b)	(c)
Zone 1	\$42,086,695	\$197,875,308	21.27%
Pekin	925,864	8,190,696	11.30%
Lincoln	<u>179,687</u>	<u>4,453,799</u>	4.03%
Total Water	43,192,246	210,519,803	<u>20.52%</u>
Chicago Metro WW	<u>6,302,300</u>	<u>13,104,757</u>	<u>48.09%</u>
Total Company	<u>\$49,494,546</u>	<u>\$223,624,560</u>	<u>22.13%</u>

The Company's proposed revenues incorporate a 10.75% return on common equity – a return 1.75 percentage points higher than the next recommended ROE - and an overall rate of return of 8.05%. IAWC Ex. 10.00 at 2. According to IAWC President Bruce Hauk, of the total revenue increase requested, 85.8% stems from capital investments.³ The outsize effect of capital investments on IAWC's rates, as well as substantial requested rate increase, highlight the need to carefully set a return on equity and overall rate of return that is fair to consumers and to investors.

IAWC also requested approval of two rider mechanisms. It withdrew its request for a pension/OPEB⁴ rider (IAWC Ex. 7.00SR (Rev.) at 10) and modified its request for a "volume balancing account" rider.

³ IAWC Ex. 1.0 at 10.

⁴ "OPEB" stands for "other post-employment benefits." See, IAWC Ex. 1.0 at 18.

The People offered the testimony of two witnesses: David J. Effron, a regulatory accountant who reviewed IAWC's costs and accounting and Scott Rubin, a regulatory analyst who reviewed IAWC's rate design and rider requests. The People support the Commission Staff's ("Staff") recommended return on equity recommendation. Utilizing Staff's cost of capital, accepting all of Mr. Effron's remaining contested adjustments, and adopting the Illinois Industrial Water Consumers/Federal Executive Agencies/Citizens Utilities Board ("IIWC/FEA/CUB") position on cash working capital, the AG recommends that the Company's \$49,494,546 requested increase be reduced by \$29,446,520 to \$20,048,035. The AG's position is summarized below.

AG INITIAL BRIEF POSITION			
Division	Rate Request - \$	Pro Forma Present	Rate Request %
	(a)	(b)	(c)
Zone 1	\$16,142,723	\$201,586,647	8.01%
Pekin	(216,824)	8,211,283	(2.64%)
Lincoln	<u>(335,452)</u>	<u>4,461,829</u>	<u>(7.52%)</u>
Total Water	15,590,447	214,259,759	<u>7.28%</u>
Chicago Metro WW	<u>4,457,588</u>	<u>13,298,789</u>	<u>33.52%</u>
Total Company	<u>\$20,048,035</u>	<u>\$227,558,548</u>	<u>8.81%</u>

Schedules A through C attached to this brief summarize the impact of the adjustments by rate zone and for the total company. AG Schedules 1.01 through 1.08 that are also attached to this brief calculate the adjusted revenue requirement for each of

IAWC's rate zones: ZN for Zone 1, CS for the Chicago Metro – Wastewater Division, PK for the Pekin Division, and LC for the Lincoln Division.

II. Capital Structure and Rate of Return

A. Contested Issues

1. Cost of Common Equity – The Commission Should Adopt Staff Witness Kight-Garlich's Recommended Return on Common Equity.

The People support Staff witness Sheena Kight-Garlich's recommended cost of common equity. Ms. Kight-Garlich recommended that an 8.12% ROE if the Commission denies IAWC's request for Rider VBA and an 8.04 ROE if the Commission approves the rider.⁵

Besides Ms. Kight-Garlich, two other witnesses submitted testimony regarding the proper ROE the Commission should approve in this proceeding. Michael P. Gorman filed testimony on behalf of IWC/FEA/CUB. Mr. Gorman recommended that the Commission adopt a 9.00% ROE.⁶ On behalf of IAWC, Paul R. Moul recommended that the Commission set the Company's ROE at 10.75%.⁷ The remainder of the People's brief on this issue explains why Mr. Moul's recommendation is an outlier and should be rejected.

Mr. Moul's recommended is grossly inflated. His ROE is so much higher than those proposed by Ms. Kight-Garlich and Mr. Gorman because Mr. Moul relied on tactics that have the effect of increasing his proposal. However, as Ms. Kight-Garlich explained,

⁵ Staff Ex. 13.0 at 1.

⁶ *See, e.g.*, IWC/FEA/CUB Ex. 1.0 at 4.

⁷ IAWC 10.00 (Rev.) at 2.

the Commission has repeatedly and consistently rejected the tactics Mr. Moul used.⁸ Ms. Kight-Garlish added that by removing the effects of two of Mr. Moul's adjustments that the Commission has repeatedly rejected reduces his proposed ROE range to 8.89% to 9.00%.

Mr. Moul's first inappropriate adjustment is to add a size-based risk premium to his capital asset pricing model ("CAPM").⁹ The Commission has rejected use of size-based risk premium adjustments in numerous cases. For example, in North Shore Gas Company's ("NS") and The Peoples Gas Light and Coke Company's ("PGL") consolidated rate cases in Docket Nos. 11-0280/11-0281 ("NS/PGL 2011 Rate Case"), the Commission rejected Mr. Moul's proposal to add a size-based risk premium to his CAPM result, stating

... it is simply not reasonable to add an adjustment for the size of a regulated public utility relative to the entire market, because the risk characteristics of regulated public utilities are simply unlike those of other firms in the market, which is composed mainly of unregulated firms.

... regulation provides shareholders with a degree of protection that is simply unavailable to non-regulated companies.¹⁰

The Commission also rejected use of a size-based risk premium adjustment to CAPM results in its IAWC's penultimate rate case, Docket No. 09-0319¹¹ as well as in its final order in Docket No. 11-0436 (at page 38). Notably, although Ms. Kight-Garlish pointed out in her direct testimony that the Commission has refused to adopt a size-based

⁸ ICC Ex. 5.0 at 42, 46, 50, 52.

⁹ IAWC Ex. 10.00 (Rev.) at 41-42.

¹⁰ ICC Docket Nos. 11-0280/11-0281 (consol.), Order at 123 (Jan. 10, 2012).

¹¹ ICC Docket No. 09-0319, Order at 113.

risk premium adjustment to CAPM results in these and other cases¹², Mr. Moul offered no response or explanation in his rebuttal testimony as to why this the Commission should deviate from its many decisions on this issue in prior cases.

Mr. Moul adjusted his discounted cash flow analysis (“DCF”) to ROE to include a leverage adjustment. Mr. Moul’s suggested leverage adjustment is another adjustment the Commission has repeatedly declined to adopt. For example, in NS/PGL’s rate cases in Docket Nos. 14-0224/14-0225 (consol.) (“NS/PGL 2014 Rate Case”) the Commission rejected Mr. Moul’s proposed leverage adjustment. The Commission noted that Mr. Moul’s CAPM result was inappropriately inflated because he “appl[ied] a Commission rejected leverage adjustment technique to the beta measurement.”¹³ The Commission also rejected Mr. Moul’s proposed leverage adjustment in both NS/PGL’s rate cases in Docket Nos. 09-0166/09-0167 (consol.) (“NS/PGL 2009 Rate Case”) (Order at 127) and Docket Nos. 07-0241/07-0242 (consol.) (“NS/PGL 2007 Rate Case”) (Order at 96). Thus, in at least three Commission cases, Mr. Moul has added a leverage adjustment to his DCF analysis. Each time, the Commission has dismissed his proposal. And as is the case with Mr. Moul’s size premium adjustment, Ms. Kight-Garlich pointed this out in her direct filing.¹⁴ Mr. Moul provided no response to this salient point in his rebuttal testimony.

A third way in which Mr. Moul boosted his ROE was to employ a risk premium model¹⁵, yet another tactic the Commission has repeatedly found to be improper. The Commission rejected Mr. Moul’s use of a risk premium analysis in: NS/PGL2014 Rate Case (Order at 134) (“this Commission has routinely rejected risk premium analysis as a

¹² Staff Ex. 5.0 at 42.

¹³ ICC Docket Nos. 14-0224/14-0225 (consol.), Order at 133 (Jan. 21, 2015).

¹⁴ Staff Ex. 5.0 at 46.

¹⁵ IAWC Ex. 10.00 (Rev.) at 32-37.

valid basis for determining return on equity); NS/PGL's rate case in Docket Nos. 12-0511/12-0512 (consol.) (Order at 208) (NS/PGL's "Risk Premium analysis for the Delivery Group is rejected"); NS/PGL's 2011 Rate Case (Order at 139) ("Mr. Moul also calculated ROE values using a Risk Premium analysis. This Commission does not favor the risk premium model which is too subjective to be a reliable tool for determining ROE"; NS/PGL's 2009 Rate Case (Order at 139) ("The Commission will not consider the results of the Utilities Risk Premium model that only the Companies have employed. We have repeatedly rejected this model as a valid basis on which to set return on equity"); and NS/PGL's 2007 Rate Case (Order at 93-93 ("The Commission again rejects the risk premium model"). So, on five separate occasions, Mr. Moul has asked the Commission to use a risk premium model as part of its ROE analysis. In each case, the Commission has declined to do so. Mr. Moul offered no reason why the Commission should reach a different conclusion here.

Mr. Moul also used a comparable earnings analysis to augment his recommended ROE.¹⁶ Like Mr. Moul's other adjustments and methodologies just discussed, the Commission has on many occasions refused to include a comparable earnings analysis as part of its ROE determination. Mr. Moul included a comparable earnings analysis in his testimony in the NS/PGL Rate Case. The Commission rejected Mr. Moul's proposal, stating

[NS/PGL also argued that comparable earnings of other companies could be used as a measure of required return. Unfortunately, the "comparable" companies used in their analysis don't include any other regulated Companies whose risk profile and earnings are lower than other types of

¹⁶ IAWC Ex. 10.00 (Rev) at 42-46.

businesses. The Commission finds this a comparison between apples and oranges.¹⁷

As noted by Ms. Kight-Garlich in her direct testimony¹⁸, the Commission has rejected a comparable earnings analysis in numerous cases going back to the early 1990s. Among those proceedings are: Docket Nos. 06-0700/06-0071/06-0072 (consol.), Order at 141-142 (“Among other things, the Commission believes that the comparable earnings test is faulty because it incorrectly assumes that earned returns on book common equity are the same as, or representative of, investor-required returns on common equity”); Docket 04-0442, Order at 43-44; and Docket No. 03-0403, Order at 41 (“The Commission has repeatedly found that the comparable earnings approach is an unsound basis for estimating a utility’s cost of common equity). Mr. Moul made no effort to explain why the Commission should deviate from its long-held conclusion.

Mr. Moul relied on another tactic the Commission has persistently rejected in responding to Ms. Kight-Garlich’s and Mr. Gorman’s respective recommended ROEs. In particular, Mr. Moul dedicated significant portions of his rebuttal testimony and surrebuttal testimony comparing Ms. Ms. Kight-Garlich’s and Mr. Gorman’s recommendations to ROEs approved by other public utility commissions around the country.¹⁹

In Docket No. 05-0597, in considering Commonwealth Edison Company’s argument that its ROE should be similar to those authorized for other electric utilities by other commissions, the Commission concluded

ComEd asserts its cost of equity should reflect the costs of equity recently approved for electric utilities in the United States. The cost of equity appropriate to ComEd, however,

¹⁷ ICC Docket Nos. 14-0224/14-0225, Order at 134 (Jan. 21, 2015).

¹⁸ Staff Ex. 5.0 at 52.

¹⁹ IAWC Ex. 10.00R at 3-6; IAWC Ex. 10.00SR at 3, 4, 6-7.

is specific to that utility. ComEd may not simply adopt the cost of equity set for other utilities scattered around the country, for which the factors and circumstances are not necessarily similar. Rather, pursuant to Section 9-201 of the Act, ComEd must prove that its proposed cost of equity is just and reasonable.²⁰

In the NS/PGL 2007 Rate Case, Mr. Moul submitted rebuttal testimony comparing the recommended ROEs from Staff and CUB and the City of Chicago to other then-recently-approved ROEs for other energy utilities.²¹ Expanding on its conclusion in Docket 05-0597, the Commission again rejected setting a utility's ROE based on the returns granted other utilities in Illinois or other jurisdictions, saying

[T]here are important reasons why a commission should not simply match each Utilities ROE to the others previously approved. If our task were merely to maximize [NS/PGL's] ability to attract capital (perhaps to retain investment in Illinois, as the Utilities suggest, Tr. 1047-48 (Moul)), the Commission could just exceed the highest returns already authorized for other utilities. But when the next utility initiated a rate case, we would have to approve an even higher return. Moreover, [NS/PGL] point out that —regulated firms must compete with non-regulated firms in the capital market.¶ NS-PGL Ex. PRM-1.0 at 41. To assure success in that competition, the Commission would presumably have to equal or exceed returns in the unregulated market as well.²²

The Commission added

Less dramatically, we could aim for an average among existing ROEs. However, some percentage of existing ROEs would have been in effect for multiple years and would have been established under different financial market conditions (e.g., with different rates of inflation and costs of debt). The Commission could narrow its comparison to, say, ROEs approved within the last two years, and peg [NS/PGL's] at the average of those. Even

²⁰ Docket 05-0597, Order at 153 (June 6, 2006).

²¹ Docket Nos. 07-0241/07-0242 (consol.). NS/PGL Ex. PRM2.0 at 3-6.

²² Docket Nos. 07/-0241/07-0242 (consol.), Order at 90 (Feb. 5, 2008).

then, we would have to ignore any differences among utilities in financial strength, capital structure, credit status and utility-specific circumstances, as well as changes in the financial market during the two-year period.

Furthermore, by determining [NS/PGL's] ROEs via comparison to existing ROEs, the Commission would be disregarding its duty to impose only cost-based and reasonable rates on [NS/PGL's] customers. Thus, if we succeeded in providing capital attraction to Illinois utilities, we would also be extracting it from Illinois businesses and homeowners, in the form of excessive rates. And, in the future, other Commissioners could reverse the inequity, by intentionally pegging [NS/PGL's] returns to the lowest comparable existing ROEs.

Plainly, although the notion that [NS/PGL] should enjoy at least an average ROE is superficially seductive, it is an unworkable and improper basis for determining utility returns. It would require us to abandon the course we, along with other commissions, have charted for decades.²³

Although Mr. Moul testified for the utilities in the NS/PGL 2007 Rate Case and is presumably aware of the Commission's conclusion in that case, he proposed here that the Commission rely on the "superficially seductive" approach the ICC repudiated in the prior cases. Moreover, Mr. Moul offered no reason why the Commission should diverge from its conclusions in those prior cases.

Finally, and perhaps most outrageously, in his rebuttal testimony, Mr. Moul testified that the return generated by his various analyses 10.70%.²⁴ Mr. Moul then stated that he rounded up the 10.70% "to the nearest one-quarter percentage point, or 10.75%." There is no other reason or explanation; Mr. Moul gratuitously added five basis points to his recommended return. The ease with which he increased his alleged professionally-

²³ *Id.* at 90-91.

²⁴ IAWC Ex. 10.00R at 30.

derived result raises serious questions regarding the credibility of Mr. Moul's testimony and his recommendations.

In sum, Mr. Moul's recommended return is seriously bloated. Mr. Moul inappropriately inflated his suggested ROE by adding adjustments, and relying on analyses, the Commission has condemned in case after case. Mr. Moul made no effort to explain away the Commission's past decisions, nor did he make any effort to explain why his presentation in this case is somehow different, thereby meriting different treatment. To top it off, Mr. Moul gratuitously added five basis points to his proposal for no stated reason other than to have a nicely-rounded-off number. The Commission should reject Mr. Moul's recommended ROE.

B. Resolved Issues

1. Capital Structure

2. Cost of Debt

C. Recommended Capital Structure and Rate of Return

III. RATE BASE

A. Contested Issues

1. Accumulated Deferred Income Taxes (ADIT) / FIN 48 – The Commission Should Remove from Rate Base the Non-Investor Funds Associated with ADIT for the FIN 48 Repairs Deduction.

As the Commission has stated and the Illinois appellate court has affirmed, “Generally, ADIT quantifies the income taxes that are deferred when the tax law provides for deductions with respect to an item, in a year other than the year in which the item is treated as an expense for financial reporting purposes. For regulated entities, ADIT is

treated as a no-cost source of capital that reduces rate base.”²⁵ This is because consumers pay rates that include the full tax bill but the utility does not pay some of the tax bill until a later date (the tax payments are deferred), providing the utility with consumer-supplied, no-cost capital.

In this case, IAWC failed to treat certain ADIT as cost-free capital, in violation of basic ratemaking and accounting principles. Specifically, while the Company took tax deductions related to repairs and realized tax savings from the repairs deduction, the Company is treating the deduction as “uncertain” under FIN 48 and not including the ADIT associated with those “uncertain” tax positions in its rate base deduction. However, until these deferred tax liabilities are actually paid to the relevant taxing authorities, the deferred tax liabilities represent non-investor, no-cost funds that are available to IAWC and should be deducted from rate base. The Commission came to this conclusion in IAWC’s last rate case, stating “...the FIN 48 amount represents a source of cost-free capital that should be reflected as a rate base deduction.”²⁶

The FIN 48 balance represents the amount of deferred tax liabilities related to uncertain tax positions that may ultimately have to be paid to the government. The FIN 48 balance represents the portion of the repairs deduction taken on IAWC’s tax returns that the Company believes is uncertain upon audit by the IRS. In this regard, the FIN 48 balance is no different from any other ADIT balance.

Consistent with basic ratemaking and accounting principles and the Commission’s conclusion in Docket No. 11-0767, AG witness Effron proposed that the ADIT deducted

²⁵ ICC Docket 11-0721, *Commonwealth Edison Co.*, Order at 56 (May 29, 2012), citing *Ameren Illinois Co. v. Ill. Commerce Comm’n*, 2012 IL APP (4th) 100962 at 5, 2012 Ill.App.3d LEXIS 175 (4th Dist. 2012).

²⁶ ICC Docket 11-0767, *Illinois-American Water Co.*, Order at 36; *see also*, IAWC Ex. 1.1 at 8-9.

from plant in service not be reduced by the FIN 48 balance. In rebuttal testimony Mr. Effron stated that the effect is to increase the balance of ADIT by \$18,434,822 and to reduce the rate base by the same amount.²⁷

In rebuttal testimony, Company witness Wilde agreed that IAWC would eliminate the adjusted FIN 48 deferred tax asset balance from rate base.²⁸ However, Mr. Wilde added that Illinois-American would not be claiming as much in tax repair deductions as previously claimed. He proposed to update the Commission about its claimed FIN48 and offsetting deferred tax asset in the AIWC's surrebuttal testimony.

In surrebuttal testimony, the Company argued that the amount of the FIN48 adjustment proposed by AG witness Effron in direct and rebuttal testimony (AG Exs. 1.1 and 3.1, Sch B-2) was incorrect and provided a much smaller amount of \$3,432,525. The Company claimed that the amount of the FIN 48 adjustment should be further reduced to \$2,485,188 to reflect the adjustment to prior repair deductions that IAWC states that it expects to take in filing its 2015 tax return.²⁹ The People accept the Company's corrected amount of the FIN 48 adjustment to rate base of \$3,432,525 rather than the original adjustment of \$18,434,822 proposed by AG witness Effron in his direct testimony.³⁰

The Company, however, did not reduce rate base by the "corrected" \$2,485,188 amount in the schedules calculating the Company's proposed surrebuttal revenue requirement as Company witness Wilde said IAWC would do. The Company appears to have removed the FIN48 repairs deduction for the 2015-2017 accruals in IAWC Schedules

²⁷ See, AG Ex. 1.0, Sch. B-2; AG Ex. 3.0 at 5; AG Ex. 3.1, Sch. B-2.

²⁸ IAWC Ex. 13.0R at. 9-10.

²⁹ IAWC Ex. 13.00SR (Rev.) at. 2-4.

³⁰ It is worth noting that IAWC chose not to change the amount of the adjustment until its surrebuttal case.

B-9 and 9.1³¹, but has not removed the \$2,485,188 from rate base, although Mr. Wilde testified that such an adjustment would be made:

- “[t]he adjustment to prior repairs deductions has been computed, and the change results in IAWC realizing \$909,707 of its FIN48 obligation, reducing the amount of the ADIT impact on rate base from \$3,432,525 to \$2,485,188” and
- “[t]he amount to be removed is \$2,485,188.”³²

In surrebuttal testimony, as support that the rate base deduction should be \$2,485,188 rather than the \$3,432,525 Company witness Wilde offered to provide a confidential disclosure of Form 3115 or a copy of the IAWC federal pro forma tax return as a compliance filing in this docket. The Company’s tax returns are filed 8 ½ months after year end.³³ Thus, the filed Form 3115 should be available with the filing of initial briefs and should be provided as evidence to support the lower rate base deduction. As for the offer of a “federal pro forma tax return,” IAWC’s offer is not definitive because it is not the “actual” tax return that will be filed and should not be accepted by the Commission as proof that the Company changed its tax considerations of its repair deductions.

In IAWC’s last rate case, Docket No. 11-0767, the Commission rejected the AG’s recommendation to not consider bonus depreciation in the calculation of accumulated deferred income taxes based upon the utility’s testimony that American Water Works Company (IAWC’s service company) had decided to not utilize 2011 bonus depreciation.³⁴ However, in information submitted in this case, it turns out that bonus depreciation was

³¹ IAWC Ex. 4.08SR (Rev.) at line 5.

³² IAWC Ex. 13.00SR (Rev.) at. 2-3.

³³ IAWC Ex. 13.00SR (Rev.) at. 3-4.

³⁴ ICC Docket No. 11-0767, Order at 70 (Sep. 19, 2012).

utilized in 2011 as shown in IAWC WPC – 5a.³⁵ That document shows that the Company applied bonus depreciation in 2008-2014 to its taxable income contrary to the Company’s assurances in Docket No. 11-0767.

The Commission should not be misled again. Without AIWC’s filed Form 3115 evidence that the Company actually changed its tax method of accounting for repairs in filing its 2015 Corporate Income Tax return, the Commission should reject the Company’s proposed change in its tax considerations of repair deductions and reduce rate base by the AG’s recommended amount of \$3,432,525.

2. Debt Return on Pension Asset – The Commission Should Reject the Company’s Proposal to Include a Debt Return on its Pension Asset.

AG witness Effron recommended that the Commission reduce rate base by the accrued “other post-employment benefits” or OPEB liability in the amount of \$1,898,284.³⁶ Mr. Effron explained that Statement of Financial Accounting Standards 106 requires the Company to accrue for the payment of future post-retirement benefits other than pensions and that when the accruals are greater than the actual cash disbursements, accrued liabilities will be reflected on the Companies balance sheets.³⁷ The Commission has consistently applied this rule in IAWC’s rate cases.³⁸

IAWC accepted Mr. Effron’s adjustment (see section B.1. below, Resolved Issues), but IAWC witness Kerckhove argued that if the Company’s rate base is reduced by the accrued OPEB liability, then the Company should be allowed to include in the cost of

³⁵ AG Group Exhibit Part 2 at 10.

³⁶ AG Ex. 3.0 at 7.

³⁷ *Id.*

³⁸ *See, e.g.*, ICC Docket No. 11-0767, Order at App A, page 4, line 18 (Sep. 19, 2012).

service a debt return on pension assets as electric utilities regulated under the Energy Infrastructure Modernization Act (“EIMA”) are permitted.³⁹ The Commission should reject the Company’s proposal to include a debt return on its pension asset in exchange for the Company’s agreement to reduce its rate base by the accrued OPEB Liability. Mr. Effron’s adjustment is based on accounting standards and is unrelated to whether the Company is allowed a return on its pension asset.⁴⁰ It should not be treated as a negotiable item.

The Company’s cost of service should not include a return on a pension asset. While IAWC refers to how a pension asset is treated under Section 16-108.5 of the Public Utilities Act (the “Act”), as a water and wastewater company, by definition, EIMA does not apply to it. IAWC is not a participating electric utility under EIMA and has not satisfied the various provisions required of the participating utilities under EIMA. IAWC is not entitled to, and should not be provided the various regulatory benefits that result from being a participating utility under that statute. In short, the formula rate statute is not germane.

The Company has presented no compelling reason for the Commission to change its prior regulatory treatment of the accrued OPEB Liability and pension asset. In the Company’s prior rate case, Docket No. 11-0767, the Commission denied the Company’s request for a pension asset to be included in rate base while also accepting the Company’s rate base deduction for the OPEB Liability.⁴¹ As it did in that case, the Commission should reject IAWC’s position and reduce rate base by \$1,898,284.

³⁹ IAWC Ex. 4.0R at 15-16.; 220 ILCS 5/16-108.5(c)(4)(D).

⁴⁰ AG Ex. 3.0 at 3-4.

⁴¹ ICC Docket 11-0767, Order at 8. (Sept. 19, 2012).

3. Cash Working Capital for Deferred Income Tax – The Commission Should Adopt IIWC/FEA/CUB’s Recommended Treatment of Deferred Income Taxes in the CWC Calculation.

In rebuttal testimony, IIWC/FEA/CUB witness Gorman recommended that no cash working capital (“CWC”) requirement be provided for deferred income taxes. He explained that this treatment of deferred income taxes for CWC is consistent with how both he and IAWC witness Walker had treated depreciation expense, which is also a non-cash item, and that the treatment was also consistent with how the Commission treats deferred income taxes in the determination of CWC requirements for formula rates.⁴²

The Company argues that its treatment of deferred taxes in the CWC is consistent with past Commission findings and with the Staff’s recommended approach in this proceeding. The Company maintains that Mr. Gorman’s proposal excludes the revenues associated with deferred taxes from the CWC calculation and therefore ignores the lag between IAWC’s recorded deferred tax amount and its collection of that amount from customers.⁴³

The Company mischaracterizes the purpose of CWC. CWC is not measured by the receipt of cash from ratepayers in relationship to the recording of expenses. Expenses such as deferred income taxes are recorded but do not reflect payment. CWC is necessary to provide the funds required to pay the day-to-day expenses incurred by the utility to provide service to customers. Deferred income taxes are not currently paid and, therefore, do not require any funds to pay the yet-to-be paid taxes. Accordingly, there is no associated CWC requirement.⁴⁴

⁴² IIWC-FEA-CUB Ex. 2.0 at 38.

⁴³ IAWC Ex. 12.00SR at 4.

⁴⁴ IIWC/FEA/CUB Ex. 2.0 at 36-37.

The Commission should adopt the treatment for deferred income taxes in the CWC calculation as proposed by IIWC/FEA/CUB to reduce both the expense portion and the revenue portion of the CWC calculation for deferred income taxes.

IV. OPERATING EXPENSES AND REVENUES

A. Contested Issues

1. Payroll Expense – The Commission Should Adopt a Vacancy Rate Based on Most Recent Data.

The Company's 2017 test year employee forecast is based on an average of 482 positions (479 full-time permanent positions and 13 additional temporary full-time summer positions from June through August 2017) reduced by a vacancy rate of 2.5% to account for approximately 12 anticipated position vacancies or 470 full-time employees (482 less 12).⁴⁵ AG witness Effron, IIWC/FEA/CUB witness Gorman, and Staff witness Daniel G. Kahle proposed adjustments to reduce payroll expense for a vacancy rate that exceeded 2.5% based upon the Company's actual experience since 2014. Each witness used a different vacancy rate and made different derivative adjustments as summarized in the table below.⁴⁶

	AG Ex. 3.1, Sch. C-2	IIWC/FEA/CUB Ex 2.0 at 26-27	Staff Ex 11, Sch. 11.08
Gross Vacancy Rate Applied	5.77%	7.92%	5.40%
Less Company Vacancy Rate	2.50%	2.50%	2.50%
Additional Vacancy Rate Applied	3.27%	5.42%	2.90%
Basis for Vacancy Rate	Avg. Jan 2014-May	Avg. June 2015- May 2016	Weighted Avg. Jan '14- Feb '16

⁴⁵ IAWC Ex. 2.00R (2nd Rev.) at 2.

⁴⁶ AG Ex. 1.0 at 12-14, AG Ex. 3.0 at 7-10; IIWC/FEA/CUB Ex. 1.0 at 9-11, IIWC/FEA/CUB Ex. 2.0 at 23-28; Staff Ex. 3.0 at 14-15, Staff Exhibit 11.0 Rev. at 10-12.

	2016		
FICA Expense	X	X	X
401K	X	X	
Group Insurance	X	X	
Defined Compensation	X		
Capitalized 2017 Payroll	X		X
Capitalized 2016 Payroll	X		

The actual vacancy percentage since 2014 has been consistently higher than the vacancy percentage assumed by the Company in forecasting the test year headcount. For May 2016, the most recent month in which data was available, the actual vacancy rate was 10.34%, for the months between July 2015 and April 2016 the highest and lowest monthly vacancy rates ranged from 7.10% to 9.41%, and the average actual monthly vacancy rate for 2014 was 4.79%.⁴⁷

Company witness Smyth asserted in rebuttal that if positions are unfilled, current IAWC employees and/or temporary employees must do the required work, increasing IAWC's overtime and temporary labor expenses. He also claimed that IAWC's increased overtime and temporary labor expenses since 2013 are due to IAWC's unfilled planned full-time positions.⁴⁸ However, Mr. Smyth's argument regarding temporary labor expense is contradicted by the fact that its actual temporary labor expense from January through May, 2016 of \$23,000 is below the budgeted year-to-date amount of \$35,000.⁴⁹

Moreover, the Company's argument that its overtime expense would increase with a higher vacancy rate is unfounded. There can be many reasons for increased

⁴⁷ AG Ex. 3.1, Sch. C-2.

⁴⁸ IAWC Ex. 2.00R at 2-10.

⁴⁹ AG Group Exhibit Part 3 at 8-9, IAWC Response to Data Request AG 10.005.

overtime and temporary labor expenses. Overtime can be the result of many factors and only a percentage of IAWC's overtime can be attributable to its actual vacancy rate.⁵⁰

For example, page 45 of the Form 10-K for December 31, 2014 for American Water Works states that there was "...an increase in salaries and wages expense in 2014 as a result of annual wage increases and *increased overtime expense attributable to an increased number of main breaks as a result of the harsh winter weather conditions* and increases in severance expense as a result of the restructuring of certain functions...."⁵¹

The Company has not provided any evidence of the percentage of the increased overtime costs that is attributable to the increased vacancy rate. Thus, the Commission should not consider the incremental overtime costs in its determination of an adjustment to recognize the Company's increasing vacancy rate.

In addition, the adjustment to recognize the Company's increasing vacancy rate should adopt the derivative adjustments proposed by AG witness Effron:

- (1) FICA payroll tax also proposed by Staff witness Kahle and IWC/FEA/CUB witness Gorman;
- (2) 401K expense and group insurance adjustments also proposed by Mr. Gorman;
- (3) Defined contribution plan that provides all employees hired after 1/1/2006 a 5.25% base pay defined contribution plan;⁵²
- (4) Capitalized 2017 payroll as proposed by Staff witness Kahle; and

⁵⁰ AG Group Exhibit Part 3 at 38-39, Staff Responses to Data Requests AG 1.0 and 2.0.

⁵¹ AG Ex. 3.0 at 9 (emphasis added).

⁵² AG Group Exhibit Part 3 at 12, IAWC Response to Data Request AG 12.003.

- (5) Capitalized 2016 payroll as the capitalized 2016 payroll represents a forecast and is not the actual capitalized 2016 payroll.

In response to an AG data request, IAWC asserted that Mr. Effron had improperly applied certain benefits to the vacancy positions, including the employee benefits of pension, OPEB, retiree medical, and ESPP.⁵³ In his rebuttal testimony, Mr. Effron removed from his calculation of his proposed adjustment the employee benefits that the Company identified as not being applicable to new hires.⁵⁴ As a result, the AG's corrected derivative adjustments for the adjustment for the increasing vacancy rate address the Company's complaints.

Three different vacancy rate methods have been proposed in this case: (1) the most recent 12-month average for the period ending May, 2016 – 7.59% proposed by IIWC/FEA/CUB witness Gorman⁵⁵; the weighted annual average from 2014 through February, 2016 – 5.40% proposed by Staff witness Kahle; and the average of the actual average monthly variances from January, 2014 through May, 2016 – 5.77% proposed by AG witness Effron.⁵⁶ The Commission should apply a vacancy rate based on the most recent data available as that data will be the most reflective of the 2017 test year. The method proposed by IIWC/FEA/CUB witness Gorman provides the vacancy rate that is based on the most recent data available. AG witness Effron's method dilutes the most recent 12 months of actual data with data from 2014 but offers a longer period of analysis. The vacancy rate proposed by Staff witness Kahle does not consider the most

⁵³ AG Group Exhibit Part 3 at 6-7, IAWC Response to Data Request AG 10.001.

⁵⁴ AG Ex. 3.1, Sch. C-2.

⁵⁵ IIWC/FEA/CUB Ex. 2.0 (Rev) at 26.

⁵⁶ AG Ex. 3.1, Sch. C-2 at 3.

recent data from March through May 2016 and, is thus, not an appropriate vacancy rate for the Commission to adopt.

The Commission should adopt the corrected adjustment proposed by AG witness Effron in his rebuttal testimony that applied a vacancy rate of 5.77% reduced by the Company's 2.5% vacancy rate to 2017 payroll expense and benefits that include the 401k, Defined Compensation, and Group Insurance, 2016 and 2017 capitalized payroll, including that include 401k, Defined Compensation, and Group Insurance.

2. Annual Performance Plan ("APP") Expense (50% Recovery) – The Commission Should Deny Recovery of Incentive Compensation that Is Dependent on American Water Achieving a Specified Earnings per Share Target Because the Company Has Not Proved that the APP Provides a Net Benefit to Ratepayers.

Company witness Watkins accepted Staff witness Kahle's adjustment to disallow 50% of the costs attributable to the Annual Performance Plan ("APP") subject to a correction regarding payroll taxes in surrebuttal testimony for purposes of narrowing the issues in this docket.⁵⁷ While the AG does not object to IAWC's concession, Mr. Effron recommended that 100% of the cost of IAWC's performance plans be disallowed because no payment can be made to any participant in the APP, or short-term variable compensation program, unless the corporate financial performance of *American Water*, IAWC's corporate parent, achieves at least 90% of the targeted earnings per share.

Company witness Robert V. Mustich stated as such:

American Water's program requires the achievement of at least 90% of target [earnings per share] performance to ensure the financial viability of the plan before any short-term variable compensation payment can be made to any participant.⁵⁸

⁵⁷ IAWC Ex. 7.00SR (Rev.) at 10-11.

⁵⁸ IAWC Exhibit 9.00 at 10.

Thus, the payout of APP to its participants is dependent upon the financial success of each of the affiliates of IAWC, not just IAWC. Since payment of the APP is dependent on the achievement of American Water to achieve a threshold financial performance level, the APP primarily benefits shareholders, not ratepayers.⁵⁹

The Commission has consistently and routinely found that it is inappropriate to include in rates the costs associated with incentive compensation programs that condition payment on corporate financial goals.⁶⁰ For example, in the Company's prior rate case, Docket No. 11-0767, IAWC did not oppose a Staff adjustment to remove a portion of the cost of the performance plan that the Company inadvertently had not removed.⁶¹ And in another IAWC rate case, the Commission disallowed all costs of the performance plans, finding that:

The Commission has consistently disallowed recovery of payouts that are tied to overall company financial goals. *As is apparent from previous rate orders, the Commission has generally disallowed such expenses except where the utility has demonstrated that its incentive compensation plan has reduced expenses and created greater efficiencies in operations which provide net benefits to ratepayers.* In this case, no such showing has been made by IAWC.

... In no way does the Commission mean to suggest that IAWC should not be using an incentive compensation plan. On the contrary, if use of the AIP helps IAWC meet its financial goals as well as minimum statutory and regulatory requirements, the Commission has no objection to its continued use. The Commission, however, does object to the notion that ratepayers should have to help encourage IAWC's employees to meet goals benefitting shareholders and meet minimum service obligations.⁶²

⁵⁹ AG Ex. 1.0 at 14-15.

⁶⁰ *Id.*

⁶¹ ICC Docket 11-0767, Order at 48. (Sep. 19, 2012).

⁶² Docket No. 07-0507, Order at 25-27 (July 30, 2008) (emphasis added).

Company witnesses Smyth,⁶³ Watkins,⁶⁴ and Mustich⁶⁵ argue that the APP Plan has reduced expenses and created greater efficiencies in operations which have benefited utility customers. The Company argues that the reduction of operating expenses by 3% since the Company's last rate case and the five-year delay between rate cases is evidence that the APP Plan has benefited utility customers.⁶⁶

But, as AG witness Effron pointed out, the Company has not shown any link between the incentive compensation plan tied to financial goals and any identified reduction in operation and maintenance expenses or delay in the filing of rate cases or, further, that these efficiencies would not have been achieved in the absence of incentive compensation based on financial goals. He argued that many factors, such as weather, water usage, and technology, can affect changes in expenses or the time between rate cases.⁶⁷ In addition, rate changes, such as the use of a QIP rider, which increased costs to consumers and revenue to the Company of \$8,762,665 during 2015⁶⁸ may affect the frequency of rate cases. Other than general assertions, the Company has provided no evidence that the incentive compensation program has affected the results of operations or its revenue increase request.

Moreover, other IAWC witnesses identified reasons for reduced expenses that have nothing to do with existence of the APP:

- Company witness Roach stated "Over the long term, *reduced usage per residential customer has helped lower operating costs*, and has helped avoid

⁶³ IAWC Ex. 2.00R (2nd Rev.) at 10-14.

⁶⁴ IAWC Ex. 7.00R at. 21-35.

⁶⁵ IAWC Ex. 9.0R at 1-7.

⁶⁶ IAWC Ex. 2.00R at 11; IAWC Ex. 7.00R at 30.

⁶⁷ AG Ex. 3.0 at 10-11.

⁶⁸ See ICC Docket No. 16-0181, IAWC Petition to Initiate Reconciliation Proceeding.

some capacity-related needs. These savings and avoided costs have benefitted customers through the ratemaking process.”⁶⁹

- Mr. Roach further added “As a result of ... ongoing reductions in water usage, the water utility industry has avoided the need to build supply, treatment, and transmission facilities to meet those now avoided additional usage demands.”⁷⁰
- Company witness Hauk stated that “And our water efficiency efforts are demonstrated *by investments in new metering and innovative data collection technologies*, and by improved business processes that help us work smarter and more efficiently and, by extension, contribute to our cost control efforts. Our ability to reduce O&M from the level approved in our 2011 rate case proves the effectiveness of these efforts, and the consequent cost benefit to our customers.”⁷¹

Company witnesses also claimed the delay in filing this rate case as evidence that customers benefited from the performance plans. In reality, the Commission Order in the Company’s last rate case, Docket No. 11-0767, was entered September 19, 2012 and the current case was filed January 21, 2016, a 41-month period. There were three prior IAWC rate cases filed since 1985 that had a filing delay greater than 41-months: Docket Nos. 07-0507 (49 months), 97-0102 (48 months), and 90-0100 (47 months). Thus, the 41-month delay in filing the current case is not exceptional nor unique. On the contrary, the repeated rate cases filed between 2000 and 2011 appear anomalous and possibly related to IAWC’s acquisitions of several water service areas. The time between rate cases can be the result of many factors, not just the existence of a performance pay plan.

⁶⁹ IAWC Ex. 8.00 at 14 (emphasis added).

⁷⁰ *Id.* at 14-15.

⁷¹ IAWC Ex. 1.0 at 12 (emphasis added).

HISTORY OF RATE CASES FILED BY IAWC⁷²					
Docket No.	Date Filed	Date Entered	Day Delay (b) Less Prior	Mo Delay (d)/30	Mo Delay Rounded
(a)	(b)	(c)	(d)	(e)	(f)
16-0093	1/21/2016		1,219	40.6	41
11-0767	10/27/2011	9/19/2012	562	18.7	19
09-0319	5/29/2009	4/13/2010	303	10.1	10
07-0507	8/31/2007	7/30/2008	1,480	49.3	49
02-0690	9/20/2002	8/12/2003	582	19.4	19
00-0340	4/17/2000	2/15/2001	847	28.2	28
97-0102	1/31/1997	12/22/1997	1,452	48.4	48
92-0116	3/13/1992	2/9/1993	479	16.0	16
90-0100	1/16/1990	11/20/1990	1,413	47.1	47
85-0202	5/1/1985	3/5/1986			

The Commission should adopt the AG’s adjustment to remove the remaining 50% of the APP because the Company has not established that the APP has been directly responsible for any reduction in operation and maintenance expenses or a delay in the filing of the current rate case or that these cost reductions would not have been achieved in the absence of incentive compensation based on financial goals.

3. Purchased Power Expense – The Commission Should Adopt the AG’s Adjustment to Purchased Power Expense to Remove IAWC’s Unsupported Anticipated Increase in Power Costs.

IAWC included electricity capacity charges in its purchased power expense. In 2015-16 the capacity charges in the Midcontinent Independent System Operator (“MISO”) area that serves some IAWC facilities jumped from \$16.00 to \$150 for June 1, 2015 through May 30, 2016. In 2016-2017 the capacity charge dropped to \$72.00.⁷³ Despite the more than 50% decrease in capacity costs for the 2016-2017 period, IAWC increased the MISO capacity charge in its test year. Mr. Effron removed the part of the Company’s pro

⁷² Rate Case History Report available at <https://www.icc.illinois.gov/reports/report.aspx?rt=4>

⁷³ AG Ex. 1.0 at 20-21.

forma adjustment to fuel, power, and chemical expense that increased production costs from the high \$150 capacity charge in 2015/2016. The Company's pro forma adjustment to increase the purchased power costs over the 2017 projected level was not supported and using the 2015/16 capacity charge of \$150.00 would likely overstate IAWC's purchased power costs.⁷⁴

In rebuttal testimony, Company witness Smyth testified that he "...agrees that, due to the capacity price flow-through, if viewed in isolation, IAWC will temporarily benefit from the reduction in capacity prices in the [MISO] territory from June 1, 2016 through May 30, 2017." However, he argued that there was no assurance that prices will not swing up again in the second half of the test year when MISO holds its capacity auction for the 2017/2018 planning year.⁷⁵

AG witness Effron agreed that while there is no assurance that prices *will not* swing up in the second half of 2017, there is also no assurance that the prices *will* go down in the second half of 2017 either.⁷⁶ The AG adjustment did not change the Company's original forecast for 2017 power costs that considered several factors including the \$150 per megawatt-day passed through MISO capacity price that was in effect through May 30, 2016.

Company witness Smyth offered that IAWC would experience a "temporary benefit" through May 31, 2017 from the impact of the capacity cost decrease in MISO's territory for the 2016/2017 planning year of \$118,000, but not the \$219,000 proposed by

⁷⁴ AG Ex. 1.0 at 20; AG Ex. 3.0 at 13.

⁷⁵ IAWC Ex. 2.0 at 14-17.

⁷⁶ AG Ex. 3.0 at 13.

AG witness Effron.⁷⁷ The Company's support for the reduction of costs of \$118,000 considers the lower \$72 per megawatt day price only through May 31, 2017 but insists Company's escalated price greater than the \$150 per megawatt day from June 1, 2017 through December 31, 2017 is appropriate.⁷⁸

The AG adjustment is conservative in that it only removes the Company's pro forma adjustment *to increase* the costs greater than the projected 2017 power costs that were based on the \$150 per megawatt-day pass through MISO capacity price, despite the fact that, as noted above, MISO capacity prices have decreased by more than 50% to \$72 per megawatt/day for 2016-2017. The Commission should adopt the AG adjustment to reduce the test year power costs \$219,035 and not unreasonably increase the projected purchased power expense.

4. Test Year Sales Level

5. Uncollectible Rate in Lincoln - The Commission Should Approve the Use of a Separate GRCF for the Lincoln Division.

IAWC applied a uniform Gross Revenue Conversion Factor ("GRCF") to all of its divisions to avoid the complexity of maintaining separate uncollectible rates for each zone. However, the Company already maintains separate uncollectible rates for each zone as evidenced by IAWC Schedule C-16, Uncollectible Expense,⁷⁹ which provides separate uncollectible ratios for each division. Line 18 of IAWC Schedule C-16 reflects an uncollectible rate for Lincoln of 0.92% and an uncollectible rate for the other districts of

⁷⁷ IAWC Ex. 2.00R (2nd Rev.) at 16.

⁷⁸ AG Group Exhibit Part 3 at 34-35, IAWC Response to Data Request AG 14.001.

⁷⁹ AG Group Exhibit Part 1 at 61.

0.95%. Thus, the lower 0.92% uncollectible rate should be used in the GRCF for Lincoln rather than the higher 0.95%.⁸⁰

A separate GRCF for each district is appropriate. Having four GRCFs rather than one GRCF adds little complexity for a rate case when there are already separate revenue requirements for each district.⁸¹ Moreover, doing so would be consistent with the Commission's finding in a prior IAWC rate case, Docket No. 09-0319, where the Commission concluded that the uncollectible factor used in the GRCF should be different for each district. The Order stated:

The Commission also finds convincing AG/JM's assertion that its proposal to calculate a district-specific uncollectibles factor produces a more accurate estimate of the district specific revenue requirement.⁸²

The Commission should approve the use of a separate GRCF for the Lincoln division so that consumers in that division can benefit from the lower uncollectible rate in that area.

6. Demand Study Costs – The Commission Should Remove the \$69,460 from IAWC's Revenue Requirement Associated with the Company's Proposal to Discontinue Collecting Demand Data.

In his direct testimony, AG witness Rubin testified that he agreed with IAWC's request to discontinue collecting demand data, stating that the demand data the utility has gathered for this case should be useable for many years going forward.⁸³ Accordingly, Mr. Rubin recommended that Company's revenue requirement be reduced by \$69,460.⁸⁴

⁸⁰ AG Ex. 1.1, Sch. A-2, Ln. 2; AG Ex. 3.1, Sch. A-2, Ln. 2.

⁸¹ AG Ex. 3.0 at 51-53.

⁸² ICC Docket 09-0319, Order at 60 (Apr. 13, 2010).

⁸³ AG Ex. 2.0 at 16.

⁸⁴ *Id.* at 16-17; AG Ex. 2.7.

In his rebuttal testimony, Mr. Rubin explained that in a response to an AG data request attached to his direct testimony, IAWC stated that it would save by no longer collecting demand data. The \$69,460 number is the basis for Mr. Rubin's proposed reduction to the revenue requirement. However, in its rebuttal testimony, the Company did an about-face and claimed that there are no savings associated with discontinuing collecting demand data because the expenses are deferred, and not considered a current cost of service.⁸⁵

IAWC should be held to its first position, that is, that \$69,460 should be removed from its revenue requirement request. In its direct case, Company witness Jeffrey T. Kaiser testified that "IAWC would accept an adjustment to test year expenses to remove the cost related to the collection and compilation of the direct measurement data if the Commission approves discontinuance of the data collection."⁸⁶ And, in responding to the AG's data request, the Company quantified the amount associated with collecting the demand data that should be removed from the revenue requirement.

The Company's change in position in rebuttal responded to no party. No party opposed AIWC's proposal to discontinue collecting demand data and to remove the associated costs from its proposed revenue requirement. The Company should not be rewarded for reversing course on a position when no party has opposed its request. The \$69,460 should be removed from the revenue requirement approved in this case.

C. Recommended Operating Revenues and Expenses

V. Riders

⁸⁵ AG Ex. 4.0 at 1.

⁸⁶ IAWC Ex. 3.00DT at 31-32.

A. Contested Issues

1. Rider VBA – The Commission Should Adopt AG Witness Rubin’s Recommended Modifications to Rider VBA.

As part of its direct case, IAWC proposed a volume balancing adjustment rider (“Rider VBA”).⁸⁷ In his direct testimony, AG witness Rubin testified that the AG does not oppose the Company’s Rider VBA in concept, but made several recommended changes to the tariff. Perhaps the most important change was Mr. Rubin’s observation that the rider as originally proposed would inappropriately recover certain variable costs, such as the costs of chemicals, the cost of power to operate pumps, and certain waste disposal costs. Mr. Rubin proposed that these variable costs not be recovered through Rider VBA.⁸⁸ Staff witness David Brightwell came to the same conclusion in his direct testimony.⁸⁹

In rebuttal, the Company stated that it was not opposed to the respective alternatives to IAWC’s Rider VBA proposed by Mr. Rubin and Dr. Brightwell. According to IAWC, Mr. Rubin’s and Dr. Brightwell’s respective proposals remove variable costs from recovery through Rider VBA. Company witness Watkins went on to say that if the Commission does not adopt IAWC’s version of the rider, it should adopt a tariff similar to that proposed by Mr. Rubin.⁹⁰ In surrebuttal, Mr. Watkins testified that in the interest of narrowing the issues in this matter, the Company is willing to accept Dr. Brightwell’s proposal to recover only volumetric charges through Rider VBA and to also use Dr. Brightwell’s suggested tariff formula.⁹¹ Subsequently, in response to a Company discovery request to the AG, the

⁸⁷ IAWC Ex. 7.00 at 4-20.

⁸⁸ AG Ex. 2.0 at 14.

⁸⁹ Staff Ex. 8.0 at 5-7.

⁹⁰ IAWC Ex. 4.00R at 4.

⁹¹ IAWC 7.00SR (Rev.) at 2.

AG agreed to accept Dr. Brightwell's proposal to remove volumetric costs from Rider VBA recovery and his recommended Rider formula.⁹²

While the AG agrees with Staff and IAWC on those points, Mr. Rubin recommended two other changes to Rider VBA that should be adopted. The first issue concerns IAWC's proposal that all Zone 1 regions pay the same rate adjustments under Rider VBA. Mr. Rubin explained that the Company's proposal is unfair to the South Beloit and Chicago Metro Lake regions because the customers in these areas variable costs are not recovered through base rates like the customers in all of the other areas in Zone 1. Instead, South Beloit and Chicago Metro Lake pay their variable costs (consisting of purchased water) through a separate rider and, as a result, pay lower fixed charges than other Zone 1 customers.⁹³ To address this issue, Mr. Rubin calculated the percentage of fixed charges for both the South Beloit and Chicago Metro Lake regions. His calculations and results are shown on AG Ex. 2.6.

In his rebuttal testimony, Mr. Rubin testified that in response to a AG discovery request to IAWC, the Company agreed that it was appropriate to calculate a separate Rider VBA charge for the South Beloit and Chicago Metro Lake regions.⁹⁴ However, in its rebuttal testimony, IAWC shifted positions and Mr. Watkins asserted that the administrative burdens would be too great, and the rate impacts too small, to justify separate VBA charges for the South Beloit and Chicago Metro Lake areas.⁹⁵

In his rebuttal, Mr. Rubin took issue with Mr. Watkin's characterization that the rate impacts are insignificant. Mr. Rubin's calculations showed that IAWC's proposed rate

⁹² See, IAWC-AG Stipulated Cross-Ex. 2.00 at 1.

⁹³ AG Ex. 2.0 at 15.

⁹⁴ AG Ex. 4.0 at 3; AG Ex. 4.1.

⁹⁵ IAWC 7.00R at 9-11.

for 100 gallons of water for customers in the portions of Zone 1 that do not purchase water (that is, areas other than South Beloit and Chicago Metro Lake) would change by as much as 2%.⁹⁶ Mr. Rubin's analysis shows that the rate adjustments for the South Beloit and Chicago Metro Lake areas would be 1.9% and 0.3% of base rates in 2013, respectively.⁹⁷ Mr. Rubin concluded that, contrary to Mr. Watkins' assertion, such impacts on base rates are significant and justify separate Rider VBA calculations for the purchased-water areas of Zone 1.⁹⁸

Mr. Rubin's second point regarding Rider VBA is that wastewater customers should be exempt from the tariff. Mr. Rubin explained that unlike water revenues, approximately 85% of the Company's wastewater revenues are fixed. Given that due to the very high level of fixed costs means that wastewater customers pay a flat rate that varies very little from month-to-month, there is no reason to apply Rider VBA to wastewater customers.⁹⁹

In sum, consistent with Mr. Rubin's recommendations, the Commission should modify Rider VBA in two ways: (1) to require IAWC to calculate separate Rider VBA charges for the Beloit and Chicago Metro Lake areas of Zone 1 and (2) to exclude wastewater customers from the tariff.

B. Resolved Issues

- 1. Pension/OPEB Rider**
- 2. Rider QIP Recommendation**

⁹⁶ AG Ex. 4.0 at 3-4.

⁹⁷ *Id.* at 4; AG Ex. 4.3.

⁹⁸ AG Ex. 4.0 at 4-5.

⁹⁹ AG Ex. 2.0 at 15-16.

VI. Rate Design and Cost of Service

A. Contested Issues

- 1. Purchased Power Cost Allocation**
- 2. Simplification of Metered Large User Water Tariff**
- 3. Customer Records, Collection Labor, Uncollectible Accounts – The Commission Should Require IAWC to Remove Collection and Uncollectible Costs from the Utility’s Proposed Customer Charge.**

AG witness Rubin testified that IAWC included all “Costs Related to Collecting and Billing” (or \$34,686,684) in its proposed customer charge. That amount includes \$4,150,323 in collection expenses and \$2,587,363 of uncollectible accounts. Those costs total \$6,737,686.¹⁰⁰

Mr. Rubin testified that by including collection expenses and uncollectibles in the customer charge, all customers are responsible for an equal amount of the expenses. Because collection expenses and uncollectibles are a function of bill size, which is primarily a function of usage, Mr. Rubin testified it is unfair to charge all customers the same amount for these costs. Rather, these costs should be apportioned based on customer usage; that is, customers using greater amounts of water are responsible for a larger share of collection expenses and uncollectibles than those customers using less water. Mr. Rubin recommended that \$6,737,686 be removed from “Costs Related to Collecting and Billing.”¹⁰¹

In his rebuttal testimony, Mr. Rubin expanded on his proposal. He explained that it is fairer to require all residential customers to pay an equal percentage of their bill to

¹⁰⁰ *Id.* at 8.

¹⁰¹ *Id.* at 8-9.

recover collection expenses and uncollectibles than to charge each customer the same amount as proposed by IAWC. Mr. Rubin added that while there is no “right” answer as to how to recover these costs, because there is a relationship between water usage and non-payment, it is fairer that all residential customers pay an equal percentage of their bills, resulting in higher-use customers paying a greater absolute amount of collection expenses and uncollectibles.¹⁰²

For these reasons, the Commission should adopt Mr. Rubin’s proposal to remove \$6,737,686 from IAWC’s “Costs Related to Collecting and Billing.”

4. Zone 1 5/8 Meter Charge

5. Limitation of Increase by Class

6. Demand Factors

B. Resolved Issues

1. Declining Block Usage Charge for Non-Residential Customers in Chicago Metro Sewer

2. Public Fire Charges

3. Certain Large User

4. Distribution Main Allocation to Large Users

¹⁰² AG Ex. 4.0 at 6-7.

VII. Conclusion

For the reasons discussed above, the Peoples of the State of Illinois respectfully request that the Illinois Commerce Commission enter an order consistent with their recommendations above.

Respectfully submitted,

PEOPLE OF THE STATE OF ILLINOIS

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